



COUNTY EMPLOYEES' RETIREMENT SYSTEM

**From The Office Of State Auditor
Claire McCaskill**

**Report No. 2002-89
September 12, 2002
www.auditor.state.mo.us**

AUDIT REPORT



Office Of The
State Auditor Of Missouri
Claire McCaskill

September 2002

The following report is our review of the County Employees Retirement System.

As noted in our prior audit, the County Employees' Retirement System (CERS) did not solicit proposals before entering into a contract with a firm to provide actuarial and consulting services in October 1998. During 1999, 2000, and 2001, the CERS entered into several more contracts with the same firm, all without soliciting proposals. The additional contracts entailed actuarial valuations and special analyses, general consulting services, retirement plan and computer system database redesigns and enhancements, and additional ongoing systems support.

During 1999, 2000, and 2001, the CERS paid the firm approximately \$2,716,000 through these various contracts, including approximately \$506,000 for actuarial services, \$2,021,000 for other consulting and system design services, and \$189,000 in related out-of-pocket expenses. In addition, in January 2002, the CERS contracted with a new firm for actuarial services, also without soliciting proposals.

As noted above, the CERS reimbursed expenses totaling \$189,000 to its prior actuarial/consulting firm during 1999, 2000, and 2001. While invoices submitted by the company grouped the expenses into various categories such as general administrative expenses, airfare, transportation, lodging and meals, no supporting documentation was requested or received to substantiate the expenses claimed.

The CERS authorized and/or paid for some services prior to, or without, signing a valid contract. To ensure each party's rights, responsibilities, and obligations are clearly understood and enforceable, signed contracts should be in place before the CERS authorizes commencement of, or pays for, future services.

After soliciting proposals, in December 1999 the CERS entered into an agreement with a law firm to serve as the system's legal counsel for an annual retainer of \$75,000 (paid monthly) with any litigation services billed separately on an hourly basis. While the law firm submitted detailed billings for litigation services, the CERS neither requested nor received detailed invoices to document the services provided under the retainer fee. In October 2000, the CERS approved the law firm's request to raise the annual retainer to \$150,000 effective December 2000. An additional annual increase of 3 to 5 percent, not to exceed \$7,500 annually, was approved by the CERS in February 2002.

To allow the CERS to monitor the matters being referred to the legal counsel and the services being provided, and to ensure the contract is fair to both parties, the CERS should require the law firm to submit monthly invoices detailing the dates, work performed, attorneys involved and time incurred for matters covered under the retainer agreement. Previous law firms used by the CERS did submit such detailed invoices.

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YELLOW SHEET

COUNTY EMPLOYEES' RETIREMENT SYSTEM

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STATE AUDITOR'S REPORT



CLAIRE C. McCASKILL
Missouri State Auditor

Honorable Bob Holden, Governor
and
Board of Directors
and
Sarah J. Maxwell, Executive Director
County Employees' Retirement System
Jefferson City, MO 65102

The State Auditor is required under Section 50.1030.5, RSMo 2000, to audit the County Employees' Retirement System and the operations of the board. The system engaged Williams Keepers, LLC, Certified Public Accountants (CPAs), and Evers and Company, LLC, Certified Public Accountants, to audit the system's financial statements for the years ended December 31, 2001 and 2000, and 1999, respectively. To satisfy our statutory obligation and minimize duplication of effort, the State Auditor has used the work of the CPAs. We reviewed the reports and substantiating working papers of the CPAs to satisfy ourselves as to the appropriateness of using the reports, and we accept them in partial fulfillment of our responsibility under Section 50.1030.5. The additional objectives of this audit were to:

1. Review compliance with certain legal provisions.
2. Review certain management practices.

Our audit was conducted in accordance with applicable standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such procedures as we considered necessary in the circumstances. In this regard, we reviewed minutes of meetings, written policies, financial records, and other pertinent documents, and interviewed various personnel of the system.

As a part of our audit, we assessed the system's management controls to the extent we determined necessary to evaluate the specific matters described above and not to provide assurance on those controls. With respect to management controls, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation.

Our audit was limited to the specific matters described above and was based on selective tests and procedures considered appropriate in the circumstances. Had we performed additional procedures, other information might have come to our attention that would have been included in this report.

The accompanying History, Organization, and Statistical Information is presented for informational purposes. This background information was obtained from the system's management and was not subjected to the procedures applied in our audit system.

The accompanying Management Advisory Report presents our findings arising from our audit of the County Employees' Retirement System.

A handwritten signature in black ink, reading "Claire McCaskill". The signature is fluid and cursive, with the first name "Claire" written in a larger, more prominent script than the last name "McCaskill".

Claire McCaskill
State Auditor

August 28, 2002 (fieldwork completion date)

The following auditors participated in the preparation of this report:

Director of Audits:	Kenneth W. Kuster, CPA
Audit Manager:	Douglas J. Porting, CPA
In-Charge Auditor:	Rosemarie Edwards

MANAGEMENT ADVISORY REPORT -
STATE AUDITOR'S FINDINGS

COUNTY EMPLOYEES' RETIREMENT SYSTEM
MANAGEMENT ADVISORY REPORT –
STATE AUDITOR'S FINDINGS

1.	Actuarial and Consulting Services
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- A. As noted in our prior audit, the County Employees' Retirement System (CERS) did not solicit proposals before entering into a contract with a firm to provide actuarial and consulting services in October 1998. During 1999, 2000, and 2001, the CERS entered into several more contracts with the same firm, all without soliciting proposals. The additional contracts entailed actuarial valuations and special analyses, general consulting services, retirement plan and computer system database redesigns and enhancements, and additional ongoing systems support.

During 1999, 2000, and 2001, the CERS paid the firm approximately \$2,716,000 through these various contracts, including approximately \$506,000 for actuarial services, \$2,021,000 for other consulting and system design services, and \$189,000 in related out-of-pocket expenses. In addition, in January 2002, the CERS contracted with a new firm for actuarial services, also without soliciting proposals. Without requesting competitive proposals for such services, the CERS has not ensured it is receiving these services at a fair price.

- B. As noted above, the CERS reimbursed expenses totaling \$189,000 to its prior actuarial/consulting firm during 1999, 2000, and 2001. While invoices submitted by the company grouped the expenses into various categories such as general administrative expenses, airfare, transportation, lodging and meals, no supporting documentation was requested or received to substantiate the expenses claimed.

To ensure that expenses for which reimbursement is sought are valid, reasonable and necessary, the CERS should require and review adequate supporting documentation prior to payment.

- C. The CERS authorized and/or paid for some services prior to, or without, signing a valid contract.

1. The CERS signed a contract with the prior actuary/consultant in December 1999 for general consulting services related to plan changes. However, the firm actually began performing the contracted services in May 1999 and had completed and billed approximately 70% of the work before the contract was signed. Another contract was signed with the firm in February 2000 to begin modifications and enhancements of the system's proprietary software. Again, the firm had actually worked for several months and had performed and completed approximately 81% of the contracted services before the contract was ever signed. An addendum to

the contract was necessary two months later to support an additional \$56,000 in services provided between the signing of the original contract in February 2000 and completion of the contract in April 2000.

2. To help fulfill its contracts for retirement plan software and database analysis and updates, the prior actuarial/consulting firm subcontracted some of the computer analysis and programming functions to another vendor. Approximately \$308,000 for the subcontractor's services was billed and paid through the consulting firm and was counted against the consultant's contracted cap on fees. However, after the consultant's contractual limit was reached, an additional \$128,000 in fees for the subcontractor was billed to and paid by the CERS in June, July and August 2001, even though the CERS had no contract with the subcontractor and had no involvement in selecting the subcontractor.

To ensure each party's rights, responsibilities, and obligations are clearly understood and enforceable, signed contracts should be in place before the CERS authorizes commencement of, or pays for, future services.

WE RECOMMEND the CERS Board of Directors:

- A. Solicit proposals for all professional services.
- B. Require and review adequate supporting documentation prior to reimbursing contractors' expenses.
- C. Ensure written contracts are signed with all vendors before work commences and before paying for such work.

AUDITEE'S RESPONSE

- A. *The Board does seek proposals for most services when time constraints allow for a meaningful solicitation and review process. In a few instances, when a vendor has established a proven track record with CERS or when time is of the essence, CERS has continued its relationship with those vendors without solicitations. This process has allowed CERS to continue delivering services to its members in a timely fashion. CERS understands the benefits of soliciting proposals and will continue to solicit proposals from vendors as appropriate. However, CERS does note that its legal counsel has advised that it is not legally required to solicit proposals for professional services.*
- B. *CERS has required documentation of expenses from its vendors. Vendors have provided detailed expenses, and CERS can verify items such as travel expenses by its own records of when vendors traveled on behalf of CERS. CERS will continue requiring documentation of expenses from its vendors and will request more detail on major expenses.*

- C. *CERS generally requires written contracts of all its vendors. The matters noted in this report occurred in 1999 and 2000 and due to time constraints of the work involved, some work began before contracts were finalized. Subsequently, CERS has required written contracts prior to the commencement of work.*

2. Legal Fees

After soliciting proposals, in December 1999 the CERS entered into an agreement with a law firm to serve as the system's legal counsel for an annual retainer of \$75,000 (paid monthly) with any litigation services billed separately on an hourly basis. While the law firm submitted detailed billings for litigation services, the CERS neither requested nor received detailed invoices to document the services provided under the retainer fee. In October 2000, the CERS approved the law firm's request to raise the annual retainer to \$150,000 effective December 2000. An additional annual increase of 3 to 5 percent, not to exceed \$7,500 annually, was approved by the CERS in February 2002. Legal fees incurred by the CERS with this firm and prior firms for the four years ended December 31, 2001, were approximately as follows:

Year Ended December 31,			
2001	2000	1999	1998
\$ 150,644	109,296	215,692	200,284

To allow the CERS to monitor the matters being referred to the legal counsel and the services being provided, and to ensure the contract is fair to both parties, the CERS should require the law firm to submit monthly invoices detailing the dates, work performed, attorneys involved and time incurred for matters covered under the retainer agreement. Previous law firms used by the CERS did submit such detailed invoices. In addition, upon request, the current law firm provided the State Auditor's Office with a statement of service dates and hours incurred.

WE RECOMMEND the CERS Board of Directors require its legal counsel to provide detailed invoices to document work performed under the retainer agreement.

AUDITEE'S RESPONSE

CERS's legal counsel will provide detailed invoices when requested. CERS's legal counsel is retained on a flat rate basis. Certain matters referred to legal counsel are potential subjects of litigation. All are privileged attorney-client communications. Documenting some of these matters by way of a detailed bill that could be the subject of a discovery request would not serve CERS's legal interests. However, CERS will explore with its legal counsel how it can obtain additional detail on billings while protecting the confidentiality of sensitive issues.

This report is intended for the information of the management of the County Employees' Retirement System and other applicable government officials. However, this report is a matter of public record and its distribution is not limited.

FOLLOW-UP ON PRIOR AUDIT FINDINGS

COUNTY EMPLOYEES' RETIREMENT SYSTEM FOLLOW-UP ON PRIOR AUDIT FINDINGS

In accordance with *Government Auditing Standards*, this section reports the auditor's follow-up on action taken by the County Employees' Retirement System on findings in the Management Advisory Report (MAR) of our prior audit report issued for the two years ended December 31, 1998.

Professional Services Contracts

The County Employees' Retirement System (CERS) did not solicit proposals for an actuarial consulting service and plan design contract or a legislative consulting contract.

Recommendation:

The CERS Board of Directors request proposals for all professional services.

Status:

Partially implemented. While the CERS did solicit proposals for some professional services, additional contracts were signed for plan design and consulting services without requesting proposals. See MAR finding number 1.

HISTORY, ORGANIZATION, AND
STATISTICAL INFORMATION

COUNTY EMPLOYEES' RETIREMENT SYSTEM HISTORY, ORGANIZATION, AND STATISTICAL INFORMATION

The County Employees' Retirement System (CERS) was created under an act of the 87th General Assembly, commenced actual operations on August 28, 1994, and is governed by Sections 50.1000 to 50.1300 of the Revised Statutes of Missouri. The CERS is a mandatory cost-sharing multiple-employer, statewide public employee retirement system for certain employees in each county of the state, except any city not within a county (which excludes the City of St. Louis) and counties of the first classification with a charter form of government. The System is a defined benefit plan providing retirement and death benefits to its members.

The responsibility for the operation and administration of the retirement system is vested in the CERS Board of Directors, consisting of nine elected CERS members representing different, elective county offices, and two directors, who have no beneficiary interest in the system, appointed by the governor. All board members serve four year terms. As of December 31, 2001, the members of the Board of Directors were:

<u>Name</u>	<u>Position</u>	<u>Term Expires</u>
Kay Murray (1)	Chairperson	December 31, 2001
Dick Jones (2)	Vice Chairperson	December 31, 2003
Elaine Luck	Secretary	December 31, 2002
Jerry Reynolds (3)	Member	December 31, 2004
Rosemary Gannaway (4)	Member	December 31, 2004
Bettie Johnson	Member	December 31, 2002
Wayne Scharnhorst (1)	Member	December 31, 2001
Frank Sifford	Member	December 31, 2002
Fred Ward (1)	Member	December 31, 2001
Conny Dover	Appointed Member	January 1, 2004
Don Cupps	Appointed Member	January 1, 2004

- (1) Reelected January 1, 2002.
- (2) Secretary for 2002.
- (3) Chairperson for 2002.
- (4) Vice-Chairperson for 2002.

Sarah J. Maxwell has served as Executive Director since her appointment on February 26, 1998. The Executive Director coordinates the daily operation of the retirement system and with the approval of the board, contracts for professional services needed to operate the system.

The Board of Directors appointed Aon Consulting, Inc., of Atlanta, Georgia as actuarial and plan design consultants. Effective January 25, 2002, Northern Trust Retirement Consultants, L.L.C., of Atlanta, Georgia, was appointed actuarial consultant. As of December 31, 2001, the following investment managers held investments for the CERS: Boone County National Bank of Columbia, Missouri; Zurich Scudder of New York City, New York; Roxbury Capital

Management, LLC of Minnetonka, Minnesota; Brandes Investment Partners, LP of San Diego, California; Loomis, Sayles & Co., LP of Chicago, Illinois; Rockwood Capital Advisers, LLC of St. Louis, Missouri; and Dalton, Greiner, Hartman, Maher & Co., of New York City, New York. Key Trust Company of Cleveland, Ohio serves as the system's investment custodian. Bryan Cave of Jefferson City, Missouri serves as the system's legal counsel. Asset Consulting Group, Inc. of St. Louis, Missouri serves as the system's investment consultant. Madsen and Wright, Inc. of Jefferson City, Missouri serves as the system's legislative consultant. Williams Keepers, CPAs, LLC of Columbia, Missouri serves as the system's independent auditor.

As of December 31, 2001, there were 111 contributing employers to the fund which includes 9,780 active members, 316 inactive members, 855 terminated vested members, and 1,358 retired members and beneficiaries.

As of December 31, 2001, membership, required contributions, and benefits provided under the CERS are generally as follows:

Eligibility

Membership is provided for any county elective or appointive officer or employee who is hired and fired by the county, or by the circuit court located in a county of the first classification without a charter form of government which is not participating in LAGERS, and whose work responsibilities are directed and controlled by the county, or by the circuit court of such counties noted above, and who is compensated directly from county funds whose position requires the actual performance of duties of not less than one thousand hours per calendar year, with the exception of any city not within a county and any county of the first classification having a charter form of government. Individuals who are specifically excluded from CERS include county prosecuting attorneys, covered under the Prosecuting Attorneys' and Circuit Attorneys' Retirement System; circuit clerks and deputy circuit clerks, covered under the Missouri State Employees Retirement System; and county sheriffs, covered under the Sheriff's Retirement System. Prior to January 1, 2000, eligible county employees could opt out of the retirement system. Since January 1, 2000, any county employees who were members as of that date, and all eligible employees hired since that date, no longer have the right to opt out of the system. Eligible county employees who previously opted out of the system may, under certain conditions, become members of the system again.

County Contributions

Funding is provided in accordance with Section 50.1020, RSMo. In all counties, except first class counties having a charter form of government and any city not within a county, the retirement system receives a portion of delinquent property tax penalties, late assessment penalties, a portion of document recording fees, a portion of merchants licenses, and any interest derived from the collection and investment of any part of the penalties and fees. The office of Secretary of State also collects and remits fees to the system for certain filing transactions.

Employee Contributions

In all counties except counties of the first class having a charter form of government and any city not within a county, the retirement system receives a 2 percent payroll deduction from the compensation of all covered county employees who are not members of the Local Government Employees' Retirement System (LAGERS). Employees who qualify for membership in LAGERS are not subject to any payroll deductions in connection with their membership in the CERS.

Service Retirement Benefits

Service retirement benefits are payable to members who have terminated covered employment and who have met certain eligibility requirements.

NORMAL RETIREMENT

A member may retire with a full benefit at age sixty-two with eight or more years of creditable service.

The monthly service retirement benefit for members retiring on or after January 1, 2000, who do not belong to LAGERS, is the greater of 1) twenty-four dollars multiplied by years of creditable service, up to a maximum of twenty-five years, or 2) an amount determined according to a statutory formula taking into account the member's "targeted replacement ratio", average final compensation, years of creditable service up to a maximum of twenty five years, and monthly primary Social Security benefit. For persons who were members of the system as of December 31, 1999, the normal annuity may not be less than the annuity the member had earned under the terms of the retirement system in effect on that date.

The service retirement benefit for LAGERS members are calculated at sixty-six and two-thirds percent of the normal annuity determined above.

EARLY RETIREMENT

A member with eight or more years of creditable service may elect to receive a retirement annuity after reaching age fifty-five. The normal annuity shall be reduced by four-tenths of one percent for each month the commencement date of the annuity precedes age sixty-two, and an additional three-tenths of one percent for each month the commencement date of the annuity precedes age sixty.

PAYMENT OPTIONS

A retiring member may select the form of payment of the retirement benefit from among several options. These options include 1) a life income annuity whereby the retiree receives a full benefit until the retiree's death with no survivor option, 2) a life income annuity with 10 years certain whereby the retiree receives a full benefit until the retiree's

death with 120 monthly payments guaranteed, or 3) one of three (50 percent, 75 percent or 100 percent) joint and survivor options to provide survivor benefit coverage in varying degrees after the retiree's death. Under the joint and survivor options, the retiree would receive a lesser monthly payment during the retiree's lifetime than if the member had chosen the single life annuity. However, after the retiree's death, the surviving spouse will continue to receive a benefit for the survivor's lifetime in the amount of the percentage elected by the member times the monthly payment the retiree received. In the event a retiree has elected one of the survivorship options of payment and the death of the beneficiary precedes the death of the retiree, the retiree's benefit shall revert to an amount equal to the retiree's normal annuity at the time of retirement plus any cost-of-living (COLA) or other increases.

An additional option, the level-income option, is available to those retiring prior to age sixty-two and allows their income to remain level throughout retirement. Prior to age sixty-two, the CERS benefit will be inflated and, at age sixty-two, the benefit will decrease as social security benefit income is added, keeping the income level. This option is also available coupled with the 50 percent, 75 percent, or 100 percent joint and survivor options noted above.

Cost-of-Living Adjustments

All retired members are eligible for an annual post-retirement cost-of-living adjustment provided they are presently drawing a retirement benefit, have been doing so for at least one year and have not waived their right to receive the COLA increase. The adjustment, approved annually by the Board of Directors, may increase retirement benefits up to one percent per year, based on the increase in the Consumer Price Index and subject to a maximum lifetime increase of fifty percent of the initial benefit.

Termination of Employment

Members who terminate employment, other than by death, prior to attaining eight years of service forfeit all rights in the system, but may receive a refund of the member's accumulated contributions. Members who terminate employment with at least eight years of service shall be entitled to an annuity from the system calculated according to the normal annuity shown above, once the terminated member reaches the required age. A former member who has forfeited creditable service may have the creditable service restored by again becoming an employee and meeting certain other criteria, including purchase of the forfeited service.

Death Benefit

Active members' beneficiaries are eligible to receive a \$10,000 death benefit if the member dies while actively employed by the county or on recognized medical or military leave. The benefit will be paid to beneficiaries named by the member or the active member's estate.

Survivor's Benefits

If a fully vested member dies prior to retirement, the surviving spouse may apply to receive survivorship benefits under the fifty percent annuity option commencing the first day of the month following the member's death if the member was age sixty-two or older at death. If the member was under age sixty-two at death, the surviving spouse's benefit will commence on the first day of the month following the date the member would have been sixty-two. Alternatively, if the member was not aged sixty-two or older at time of death, the surviving spouse may elect to receive the actuarial equivalent benefit, reduced for early commencement, payable on the first day of any month following the date of the member's death and prior to the date the member would have turned age sixty-two.

Special Consultants

Any person who was a full time county employee, ended county employment between January 1, 1990 and August 28, 1994, and who had prior service as a county employee for at least eight years may apply to the board as a special consultant. Special consultants may be allowed to join the system and purchase prior service at a rate of three percent of the retiring member's (non-LAGERS) average final compensation times the number of years purchased or two percent of the retiring member's (LAGERS) average final compensation times the number of years purchased. Special consultants must make, at least, fifty percent of the purchase of their prior service prior to receiving a benefit, with the option of paying the other fifty percent in full at the time they begin drawing an annuity or through monthly deduction from the retirement benefit not to exceed four years.

Defined Contribution Accounts

Effective with calendar years ending after December 31, 1999, a defined contribution account will be established by the board, if actuarially feasible, on behalf of each eligible and active member of the retirement system.

Employees who are not members of LAGERS shall make contributions of seven-tenths of one percent of their compensation to the defined contribution account established on each employee's behalf. In addition, all members may make additional voluntary contributions up to certain statutory maximums, and if certain conditions are met the board shall make a matching contribution. The board's match shall be made from certain revenue sources only if it is determined that the entire amount of such revenues need not be contributed to the defined benefit retirement system in order to keep the retirement system actuarially sound. In addition to the matching contributions made by the board, counties shall also be entitled to make matching contributions to the defined contribution accounts of members employed by the county in accordance with rules and regulations formulated and adopted by the board.

Members are eligible to receive a distribution from their defined contribution account as soon as administratively feasible following termination of employment, or may choose to receive the account balance at a later time. The account balance shall be paid in a single sum. Terminating members may also elect to have any portion of the distribution, greater than \$200, rolled over to an eligible retirement plan specified by the member.

Subsequent Events

House Bill 1455, effective July 11, 2002 contained provisions that affect CERS. The legislation provides that every county employee hired on or after February 25, 2002, is subject to a 4 percent payroll contribution beginning January 1, 2003. The payroll contribution may be treated as a pretax employee contribution or some or all of it may be paid by the county as an employer contribution. The contribution is in addition to other payroll contributions already in effect.

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